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MEMORANDUM FOR: [REDACTED]

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Chief,
Latin America Branch

22 JANUARY 1974
(DATE)

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Perspectives on the Chilean Economy

Following the September coup, Chile's military junta moved rapidly to return the country to a market economy. A major readjustment of exchange rates and a lifting of price controls on most items spurred inflation during the last quarter of 1973. After a rise in prices exceeding 80% in October, the rate of inflation leveled off to less than 5% in December. The result for the year was a record leap in consumer prices amounting to 508%.

The rapid acceleration of prices after the coup stemmed from the shortages of consumer and producer goods that plagued the economy under Allende. The removal of most price controls and the exchange realignments have virtually eliminated black market activity in goods and currency. As a result, distribution has returned to normal and future price increases should be far smaller.

The readjustment to a market economy has been accompanied by a dramatic recovery in domestic production. The increase in copper production has been particularly impressive with output from major mines breaking all records in the last quarter of 1973. Production could reach an all time record of about 1 million tons, including 150-200,000 tons from small and medium mines.

Initial restraints on the expansion of copper production were largely limited to sporadic shortages of spare parts and

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light vehicles. These problems have been solved and the only major potential bottleneck appears to be smelter capacity. This problem is expected to be remedied, however, through accelerated expansion programs and relining of existing facilities. The expansion of copper production will more than compensate for any drop in world copper prices during 1974 and will help reduce the projected trade deficit to some \$300 million. It is expected that copper exports will continue to account for about 85% of Chile's foreign exchange earnings during the next three to five years.

While copper production is expected to show dramatic improvement in 1974, agricultural output is expected to register only a slight recovery. Although higher domestic prices are stimulating better organization and increased investment in agriculture, most major grains were well into the growing season when the coup occurred in September. Significant improvement, however, is likely during the 1974/75 marketing year. In fact, Chile could be self-sufficient in agriculture in several years.

Chile continues to be heavily dependent on agricultural imports. Total agricultural imports in 1974 probably will exceed \$500 million and will include an estimated 1 million tons of wheat, 500,000 tons of corn, and 50,000 tons of rice. These grains, together with raw sugar, meat, and

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cooking oil will account for some 80% of Chile's food imports. Total agricultural imports will probably account for 30% of Chile's total imports. Other major imports will include some \$300 million in petroleum products, and large amounts of capital and intermediate goods necessary for the recovery of domestic production. Chile's ability to finance this high level of imports in 1974 will depend on the availability of credits.

Chile's massive foreign debt of \$3.8 billion will continue to be a major problem for planners in 1974. Chile hopes to reschedule most of her 1973/74 debt service at the upcoming Paris Club meetings in February. Unless Chile's debt is rescheduled, the balance of payments deficit for 1974 could easily exceed \$1 billion. If renegotiation is successful, however, the Chilean economy will have an opportunity to expand and recover most of the losses suffered under Allende.

Chile's dependence on international investor and creditor confidence will be critical in 1974. The Allende government inherited positive foreign reserves of \$350 million and bequeathed negative net reserves of \$500 million. In addition, gross reserves at the time of the coup were reduced to less than \$300 million and the economy was on the verge of insolvency. If the government is successful in its efforts

to reduce government spending and cut the budget deficit in the coming year, expanded production and exports should stabilize Chile's reserve position and possibly improve it by the end of the year.

The key elements in Chile's economic recovery are, and will continue to be, the Junta's ability to muster a continued high level of traditional exports while reducing its dependence on agricultural imports. At present, the economy is showing signs of dramatic recovery from the chaos and decapitalization suffered under the previous regime. If this trend continues through 1974, investor and creditor confidence should be sufficiently restored to permit a major improvement in the Chilean economy in the years ahead.

Over the medium term there is no reason to doubt that the Chilean economy will recover if present economic policy is continued. It is reasonable to expect a growth of around 8% in 1974 and 10% in 1975. This will be in marked contrast to the 0.7% drop in GNP in 1972 and the estimated 3-5% decline in 1973.

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